



U.S. Department of Housing and Urban Development

District Office of the Inspector General  
Office of Audit  
Richard B. Russell Federal Building  
75 Spring Street, SW, Room 700  
Atlanta, GA 30303-3388  
(404) 331-3369

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Audit Related Memorandum  
No. 97-AT-244/255/256-180x

MEMORANDUM FOR: John Perry, Director, Office of Community Planning and  
Development, 4AD

FROM: Nancy H. Cooper  
District Inspector General for Audit - Southeast/Caribbean, 4AGA

SUBJECT: City of Savannah and Neighborhood Housing Services, Inc.  
Savannah, Georgia  
CDBG, HOME, and HOPE 3 Programs

We conducted a limited review of the Community Development Block Grant (CDBG) and Home Investment Partnership Act (HOME) Programs administered by the City of Savannah (City). We also performed a limited review of the HOPE 3 Program administered by Neighborhood Housing Services, Inc. (NHS). Our review focused on the use of Department of Housing and Urban Development (HUD) funds for the purchase and rehabilitation of homes for re-sale. We reviewed records maintained by the City, NHS, and closing attorneys. We also interviewed HUD, City, and NHS officials. We performed the review from May 1996 through November 1996. Our review covered the period January 1993 through September 30, 1996.

We identified deficiencies that warrant attention by HUD, the City, and NHS. We did not develop the administrative deficiencies as we normally would to meet reporting standards for generally accepted government auditing standards. Our review was not an audit of City and NHS activities and our observations are based on our limited review.

### SUMMARY

The City and NHS need to improve their administration of HUD assisted programs. We found that:

- NHS did not maintain adequate books and records and both NHS and the City lacked control over parts of their HUD programs.
- NHS used program funds to pay unallowable ( \$53,304) and unsupported (\$76,163) costs.

- NHS borrowed restricted funds including \$194,303 from HUD Programs, which may adversely impact its ability to continue as a going concern.
- NHS improperly retained \$172,485 in HOME (\$159,252) and CDBG (\$13,233) Program income.
- NHS needs to improve procurement and administration of its contracts.

### BACKGROUND

The City of Savannah received CDBG and HOME funds which were used for housing activities. The City administered many of the housing activities through its Department of Neighborhood Planning and Community Development, and NHS. NHS is a nonprofit organization, and was the City's CDBG and HOME subrecipient. It was also the City's only HOME Program Community Housing Development Organization (CHDO). During the audit period, the City was responsible for administering the following HUD programs:

	<u>CDBG</u>	<u>HOME</u>
1994 Award	\$3,344,000	\$1,120,000
1995 Award	3,468,000	1,210,000

NHS was the direct recipient of a \$551,590 HUD HOPE 3 grant and was directly responsible for providing homeownership opportunities to eligible recipients.

\* \* \* \* \*

We discussed the results of the review with City and NHS officials during the review and at an exit conference held on March 19, 1997. The City's written comments are briefly summarized in the report, and included as Attachment 2. NHS did not voice any disagreement with the findings and its comments are included as Attachment 3.

Within 60 days, please furnish this office, for each recommendation in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued as a result of this review.

We provided a copy of this memorandum to the auditee.

If you have any questions, please contact James McKay, Assistant District Inspector General, at (404) 331-3369.

Attachments:

- 1 Schedule of Ineligible and Unsupported Costs
- 2 City Comments
- 3 NHS Comments



This version does not contain the photos showing the damage at 411 E. Waldburg on page 19 or at 516 E. Seiler Avenue on page 20. The auditee comments are also excluded this version of the audit report. If you want a copy of the above mentioned pages, please request it from the Office of Audit, District 4, 75 Spring Street, SW, Room 700, Atlanta, GA 30303.

## FINDINGS AND RECOMMENDATIONS

### FINDING 1 - INCOMPLETE BOOKS AND RECORDS AND WEAKNESSES IN INTERNAL CONTROLS

NHS did not maintain formal accounting records to identify direct and indirect costs, and revenues for each HUD assisted and non-HUD activity. Also, NHS and the City did not maintain adequate internal controls to safeguard revenue collections. As a result, NHS did not account for HUD and non-HUD costs and revenues by program and budget line item. This hampered the ability of HUD and the City to monitor NHS' financial operations and deprived them of information needed to monitor NHS' performance. The internal control weaknesses increased the opportunity for undetected misuse of revenues.

#### INADEQUATE BOOKS AND RECORDS

Office of Management and Budget (OMB) Circular A-110 titled Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations (part 84.21) specifies that recipients of Federal funds must: (1) maintain effective controls over and accountability for all funds, property, and other assets and (2) maintain a financial management system to provide accounting records that adequately disclose the source and application of funds for all federally sponsored programs.

NHS did not maintain general ledgers, cash receipt and disbursement journals, general journals, and contract registers. This was significant considering the large amount of funding NHS received for HUD programs. For instance, NHS was responsible for administering and maintaining accounting records for the following programs and approximate funding amounts:

<u>Programs</u>	<u>NHS' Role</u>	<u>Authorized Funding</u>
HOPE 3	Grantee	\$ 551,590
HOME	CHDO/Subrecipient	2,517,830
CDBG	Subrecipient	583,663
Non-HUD	Non-profit operations	<u>170,907</u>
Total		<u><u>\$3,823,990</u></u>

NHS relied on its Independent Accountant's (IA) annual audit to present the financial status of its operations. The last audit was performed for the fiscal year ended September 30, 1995. The IA compiled the financial statements from information NHS provided. The IA provided an overall unqualified opinion on the financial statements. However, the IA's report commented that detailed accounting records and supporting documents were not available in sufficient quantity and quality to permit a proper examination of transactions applicable to individual funds. Therefore, the IA did not express an opinion on the individual fund statements. Also, the IA did not allocate indirect costs to specific programs, a matter HUD noted as a deficiency in past HUD monitoring reviews.

The following examples illustrate conditions we noted concerning NHS' records:

#### HOME and CDBG Programs

We found inaccuracies in the informal records NHS maintained to track rehabilitation costs by property. We reviewed the records for 71 HOME assisted properties. In 25 instances the amount NHS showed as spent did not reconcile to the amounts the City showed it provided to NHS for the work. The City records showed more. This discrepancy hindered NHS' ability to provide the City with timely and accurate HOME project completion reports. NHS took an average of 389 days to complete and submit the reports to the City. At the time of our review NHS had started efforts to reconcile its expenditures on completed projects to the funding it received from the City.

#### HOPE 3 Program

24 CFR 572.135(a) and (b) states that the recipient must separately account for all sales and that the proceeds must not be commingled with HOPE 3 grant or matching funds. Also, a recipient may use only 15 percent of funds from sales proceeds for administrative expenses.

NHS did not maintain formal accounting records to record the receipt and use of \$544,100 in gross proceeds from the sale of 11 HOPE 3-assisted homes. NHS did not maintain books and records to show project costs and the amount of program income generated from the sales. Therefore, we could not determine if NHS met the 15 percent limitation.

As of October 31, 1996, NHS had not provided HUD the required HOPE 3 annual performance reports due for fiscal years ended September 30, 1995 and 1996. These reports are designed to provide HUD with information needed to monitor NHS' success or lack of success in administering the program. NHS' lack of program accounting records contributed to or caused its failure to timely prepare and submit the reports.

### **WEAKNESSES IN INTERNAL CONTROLS**

OMB Circular A-110, part 84.21(3), states that recipients shall adequately safeguard assets and assure that they are used solely for authorized purposes. 24 CFR part 85.20 contains similar requirements for State and local Governments.

#### Weak City controls over rehabilitation loan repayments

The City did not maintain proper controls to monitor program income generated from NHS property sales and the repayment of loans NHS made from HOME and CDBG funds. The City relied on NHS to maintain and provide this information. For instance, at the time of our on-site review, NHS serviced 25 HOME loans with monthly principal and interest of \$4,147. Eight of the loans were delinquent. The City relied totally on NHS to account for and report activity related to the loans. Each month NHS provided the City

with a report along with a check for principal and interest for loan repayments. On a sporadic basis, NHS sent the City copies of closing statements to support the remittance. The City did not cross check the completeness and accuracy of loan repayments reported by NHS.

The City needs to develop and implement a system of controls to verify the accuracy of program income information provided by NHS. Such controls are particularly crucial in view of NHS' lack of adequate books and records and its inadequate controls over revenue collections. City officials stated that they relied on their monitoring visits to detect any unpaid program income.

#### Weak NHS controls related to the handling of revenues

NHS did not maintain proper segregation of duties for collecting, depositing, and recording revenues. NHS' office manager received payments (by mail and in person), prepared the bank deposits, posted deposits to the check register, and deposited the funds at the bank. The deposits were made intact but they were not always timely.

NHS has not initiated action to correct these issues. NHS' independent financial audits for fiscal years ending September 30, 1994 and 1995 disclosed untimely deposits.

HUD had previously identified problems with NHS' financial management system and NHS had promised to correct them. As early as November 1994 NHS had told HUD that it was in the process of automating its financial management system to enable it to properly account for the source and use of HUD program funds. NHS did not complete the installation and implementation of the accounting software. The financial problems continued.

### **AUDITEE COMMENTS**

The City and NHS acknowledged and accepted that NHS' accounting records deteriorated from barely adequate to unsatisfactory during the audit period. They said the extent of this inadequacy was suspected but not fully apparent until our review. NHS said it has recently obtained a new fund-based accounting software package and has made arrangements to train staff in its use. Furthermore, NHS said it has adopted a new Accounting and Financial Management Policy which segregates the duties related to cash receipts.

#### Cost allocation plan

The City and NHS assert that NHS implemented a cost allocation plan in 1995 which attributes indirect costs to its separate HUD and non-HUD assisted programs. Employees maintain timesheets and record their time by program product or service. In February 1996, NHS provided the City with a detailed annual report on the results of the cost allocation and the City determined that it provided adequate evidence to support amounts of CDBG and HOME operating costs paid to NHS in 1995.

### Segregation of duties

NHS stated that it began properly segregating duties to collect, deposit, and record revenues in 1995. Duties are now split between the loan administrator, office manager, and staff assistant.

## **OIG EVALUATION**

### Cost allocation plan

The cost allocation plan was not implemented and cannot be implemented without formal accounting records. Such records are needed to record and identify the indirect cost pool and its distribution to benefiting activities. NHS' informal spreadsheet, though a plausible effort, was not an acceptable substitute for formal accounting records with balanced accounts.

### Segregation of Duties

We found no support for NHS' comment that it had properly segregated duties.

## **RECOMMENDATIONS**

We recommend that you:

- 1A. Ensure NHS implements a financial management system that results in proper accounting for HUD funds, expenditures and program income.
- 1B. Require the City to implement procedures to cross check the completeness and accuracy of HOME and CDBG Program income collected by NHS.
- 1C. Ensure that NHS establishes proper segregation of duties to collect, record, and deposit program revenues.



## **FINDING 2 - PROGRAM FUNDS USED TO PAY INELIGIBLE AND UNSUPPORTED COSTS**

NHS used \$129,467 in program funds to pay for ineligible (\$53,304) and unsupported (\$76,163 ) costs. The ineligible costs were for delinquent taxes, liens, and loan origination fees. The unsupported costs were for assistance provided to over-income individuals, interest, and excessive property acquisition costs. The expenditures reduced the funds available to meet program objectives and hampered the City's and NHS' ability to maximize program efficiency and benefit to intended recipients.

OMB Circular A-122, Attachment A, Section A(2) and (4), states that a cost is reasonable if it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the cost was incurred. Costs are allocable to a particular cost objective in accordance with the relative benefit received.

### **PAYMENTS FOR INELIGIBLE COSTS**

#### **Inappropriate payments made to perfect clear title**

NHS inappropriately used \$37,304 of HOME program income to pay delinquent City and County taxes, and various other property liens. NHS made the payments for 35 properties that the City transferred to NHS in 1993 and 1994 by fee simple deed for one dollar each. NHS rehabilitated the properties for resale using HOME funds. The City planned to abate the liens through the Land Bank Authority but never did. As a result, the City did not convey clear title. NHS' closing attorney identified the delinquent charges while conducting title searches in preparation to sell the rehabilitated properties. NHS' payments of delinquent taxes were not reasonable because the amounts were the obligations of prior property owners. The City should have collected the payments from the previous owners.

We conducted only a limited review of HOME assisted activities and did not conduct a similar review for CDBG and HOPE 3 properties. However, we suspect the same problem exists for those programs and for other HOME assisted properties.

#### **Inappropriate loan origination fees**

NHS inappropriately charged and collected \$16,000 in loan origination fees from purchasers who received HUD assistance to acquire their homes. The payments were improper because the City's contract with NHS compensated the organization for administering its CDBG and HOME Programs. Also, NHS was the grantee for the HOPE 3 Program and received an administrative budget to administer the program.

NHS collected the funds at loan closing from the settlement proceeds of 22 homes sold in its 1994 and 1995 affordable housing auctions. The fees ranged from \$500 to \$750 per property. The fees, though deducted from borrower funds at closing, were paid with CDBG, HOME, or HOPE 3 funds used to subsidize the homeowner's purchase. Thus, the payments artificially inflated the closing costs and reduced by \$16,000 the amount of CDBG, HOME and HOPE 3 Program income received from the sales.



NHS discontinued charging the origination fees in 1995. The officials responsible for managing NHS' operations when the charges were made no longer work for NHS. Therefore, we did not determine why they charged the fees.

## **PAYMENTS FOR UNSUPPORTED COSTS**

### Inappropriate homeowner assistance payments

NHS provided \$30,220 in CDBG homeowner assistance for three individuals whose income was about twice the amount of the program's low and moderate income (LMI) limits. NHS provided the assistance for the following properties and amounts:

<u>Property</u>	<u>LMI Income Limit</u>	<u>Homeowner's Income</u>	<u>Assistance Payment</u>
A	\$ 20,150	\$ 38,000	\$ 12,220
B	20,150	45,400	1,500
C	23,050	55,703	<u>16,500</u>
Total			<u>\$ 30,220</u>

NHS, with the City's knowledge, paid the \$30,220 despite HUD's previous notice that such payments would not be allowable program costs. City officials claimed the payments were allowable because they addressed the CDBG Program's slum and blight objective. However, HUD informed the City that the rehabilitation and subsequent sale must be viewed as two separate activities. HUD said the rehabilitation portion could be accomplished under the program's LMI or slum and blight objectives. However, no homeowner assistance may be provided to individuals whose income exceeds the program's LMI limits.

### Unnecessary interest charges

NHS charged the HOME Program \$28,613 in interest for interim financing of rehabilitation work performed at 16 HOME assisted properties. This expense was not necessary because HOME Program funds were available to finance the construction and the City told NHS about their availability.

NHS calculated the \$28,613 but did not maintain detailed records to support the calculations. Thus, we did not verify the calculations nor did we determine if NHS computed similar interest charges for all HOME assisted projects. NHS frequently used the bank line of credit for interim financing. Therefore, we believe similar interest charges exist for other properties.

#### Possible excessive acquisition cost

We examined 12 acquisitions and found that in 10 cases NHS did not obtain appraisals or use other objective data to determine the fair market value for the properties. NHS used HOME Program funds to purchase the properties for rehabilitation and resale. In three cases, the acquisition prices exceeded the fair market values assigned by the Chatham County Tax Assessor by \$17,330.

An NHS official stated that the properties were acquired by the former Executive Director who did not obtain appraisals to support and justify the acquisition prices. The official said the former Executive Director determined the purchase prices through negotiation with the sellers and/or their real estate agents.

The City noted this problem during a November 1994 monitoring review of NHS' operations. The City recommended corrective actions which NHS never implemented.

### **AUDITEE COMMENTS**

#### Payments made to obtain clear title

The City acknowledged that payment of the liens that existed at the time of transfer of the properties to NHS was an inappropriate use of HOME funds. The City said it is taking steps, through its on-going review of project financial close-out reports, to ensure that these funds are returned to the local HOME investment account. The City requested that HUD allow it to use CDBG property disposition funds to reimburse NHS for the liens.

#### OIG evaluation

We believe that it would be unreasonable to allow the City to use CDBG property disposition funds to pay for the liens and delinquent taxes. The obligations accrued against the prior property owners and the City should have collected the payments from them.

#### Loan origination fees

The City recognized that its CDBG and HOME agreements with NHS neither explicitly allowed nor forbid the charging of loan origination fees. The City acknowledged that the agreements should have addressed this issue and that it would have been reasonable to forbid the charging of loan origination fees. However, the City contended that the HOME and CDBG operating grants and HOME development fees were insufficient to cover the full cost NHS incurred to implement the auction program. Therefore, the City takes the position that the loan origination fees did not, in fact, result in over compensation to NHS.

### OIG evaluation

The City's HOME and CDBG administrative contracts with NHS and the HOME development fees should have compensated NHS for all costs associated with administering the activities, including the auction. NHS should not be permitted to retain the loan origination fees. The fees were not authorized and they duplicated compensation for services.

### Inappropriate homeowner assistance payments

The City stated it did not fully understand how to apply HUD's advice to the specific transactions. The City and NHS contend that since all payments were made for rehabilitation costs, it appeared that only one activity, rehabilitation, had taken place. These properties were renovated with a total of \$84,446 in CDBG funds. NHS provided these home buyers terms similar to those allowed for all its auction sales consisting of "soft second" mortgages up to \$20,000 and/or deferred loans up to \$3,000 forgivable over 15 years. The City requests that any direct assistance activity in these cases be regarded as eligible under 24 CFR 570.204, since NHS fits the definition of an eligible subrecipient.

### OIG evaluation

We disagree with the basis for the City requesting the cost be allowed under the provisions of 24 CFR 570.204. We recognize that HUD had informed the City that the assistance payments to the over-income individuals may be allowed if they followed all the cited requirements related to eligible subrecipient, neighborhood revitalization, community economic development, energy conservation, and public services, etc. However, according to City personnel, they did not attempt to implement the activity pursuant to 24 CFR 570.204 as HUD had instructed. Therefore, at this point, the City should not be allowed to shift the costs for the sole purpose of avoiding reimbursement to the program.

### Interest charges

The City agreed with the conclusions regarding HOME assisted projects. City officials said they repeatedly pointed out to NHS management that HOME funds should be used rather than the Line of Credit funds on all HOME eligible properties. The City said it has disallowed interest charges wherever they were shown on HOME completion reports and, where appropriate, has required NHS to increase the amount of HOME ROI payable to the City.

### Acquisition costs

The City acknowledged that NHS failed to provide any evidence of an objective determination in the three cases reported. They believed that, at the very least, a third party "windshield" appraisal should have been obtained whenever NHS proposed to pay more than the tax assessor's valuation. However, the City submits that the tax assessor's valuations are typically low in Savannah, and, it is likely that NHS did not in fact pay excessive amounts for the three properties in question.

## **RECOMMENDATIONS**

We recommend that you:

- 2A. Require the City or NHS to reimburse HUD programs for inappropriate tax and lien payments (\$37,304) and loan origination fees (\$16,000).
- 2B. Require the City or NHS to identify and reimburse HUD Programs for tax and lien payments for other properties related to the City's HOME and CDBG Programs and NHS' HOPE 3 Program.
- 2C. Review and determine the allowability of the unsupported amounts paid for homeownership assistance (\$30,220), interest (\$28,613) and acquisition costs (\$17,330) and require the City or NHS to repay the amounts determined to be ineligible.

### **FINDING 3 - NHS BORROWED RESTRICTED FUNDS WHICH MAY IMPACT ITS ABILITY TO CONTINUE AS A GOING CONCERN**

NHS borrowed \$415,438 from restricted funds. The borrowings included \$194,303 from HUD programs, \$168,052 from non-HUD programs, and \$53,083 from employee tax withholdings. In addition, NHS owed \$35,303 in related fines and interest on the delinquent taxes (\$24,783) and interest (\$10,520) on the borrowed funds. The borrowings were a misuse of funds and the fines and interest are not allowable program costs. NHS did not have the cash nor the indicated capacity to raise the cash needed to repay the amounts. The borrowings and the issues discussed in the other findings of this report could adversely affect NHS' ability to continue as a going concern.

OMB Circular A-110, part 84.21(3), states that recipients shall adequately safeguard assets and assure that they are used solely for authorized purposes. OMB Circular A-122, Attachment B, Parts 14 and 19, states that grant funds may not be used to pay fines, penalties, and interest.

### **FUNDS BORROWED FROM RESTRICTED ACCOUNTS**

#### **HUD funds**

NHS' audit report for the period ending September 30, 1995, showed that it borrowed \$194,303 from restricted HUD funds. The amount included \$133,289 in CDBG funds, \$44,419 in HOME funds and \$16,595 in HOPE 3 Program funds. The audit report shows another \$168,052 involved non-HUD assisted programs. The report shows that the borrowings increased from \$3,530 at September 30, 1994, to \$362,355 at September 30, 1995.

NHS contends the audit report is in error, but has no basis to contest the accuracy of the audit report. At the time of our review NHS had not obtained an audit of its operations for the fiscal year ended September 30, 1996. Therefore, we did not determine the status of the borrowings and their repayment. The borrowings violated HUD requirements and were an unallowable use of program funds.

Based on the amounts reported by the auditor, we estimate NHS owed \$10,520 for interest attributed to loans from HUD programs (\$194,303).

#### **Use of employee withholdings**

NHS inappropriately borrowed \$53,083 by retaining funds collected for the employees' share of Federal Insurance Contribution Act (FICA) taxes. NHS retained employee FICA taxes withheld for the period April 1, 1995 to December 31, 1995. The Internal Revenue Service (IRS) assessed fines and interest of \$24,783 on the unpaid taxes. NHS had an obligation to forward those amounts plus its share of FICA taxes to the IRS when due. NHS' use of those funds represented unauthorized borrowings.

### Possible impact on NHS operations

The borrowed funds coupled with other deficiencies disclosed during our review raise serious doubts about NHS' ability to continue its operations. As of October 31, 1996, NHS had only \$15,713 on deposit in its operating account. That amount was needed for other operating costs, and was not enough to repay the borrowings and related interest and penalty costs.

### **AUDITEE COMMENTS**

The City and NHS' current management shared the concern about the inter-fund borrowing which took place in 1995. NHS said it has proposed for the CPA to correct the audit report for the fiscal year ended September 30, 1995 and that it has made considerable progress in 1996 in restoring missing and misfiled fiscal year 1995 records. In the interim, NHS has offered cash and real estate equity as temporary collateral to secure the apparent obligation by the unrestricted fund to the restricted funds. This collateral totals \$387,066.

In November 1996 and January 1997, NHS paid the IRS \$53,083 and \$18,522.92 respectively for delinquent taxes and interest. NHS said the IRS waived the fines and that they paid the amounts with a Neighborhood Reinvestment Corporation grant.

### **OIG EVALUATION**

We evaluated the collateral NHS said was offered to assure repayment of the loans. The collateral inappropriately included \$204,518 in HUD program cash (\$122,075) and property (\$82,443). The remaining collateral (\$182,548) was not sufficient to secure repayment of the loans.

As mentioned in Finding 1, NHS did not keep records to account for the source and application of funds. Therefore, further confirmation is needed to assure NHS did not use HUD program funds for the payments.

### **RECOMMENDATIONS**

We recommend that you:

- 3A. Ensure that NHS obtains a current financial audit of its operations with a determination of the amount of CDBG, HOME, and HOPE 3 funds, including the \$194,303 program income, used for inappropriate purposes.
- 3B. Require NHS to repay any amounts used for inappropriate purposes, including the \$194,303 mentioned in the finding, if supported by the subsequent independent audit.
- 3C. Verify that NHS did not use CDBG or HOME funds for amounts NHS paid to the IRS for payroll taxes and interest.



#### **FINDING 4 - NHS IMPROPERLY RETAINED HOME AND CDBG PROGRAM INCOME**

NHS improperly retained \$172,485 in HOME (\$159,252) and CDBG (\$13,233) Program income. NHS should have returned the funds to the City or deposited them to a special account for reuse. Instead, NHS inappropriately used the funds to repay advances from a line of credit (LOC) NHS obtained for interim financing of construction work. As a result, the City was denied the program income for use on other projects.

#### **CONTRACT TERMS VIOLATED**

NHS' contracts with the City for HOME activities provided that NHS remit to the City returns on investment (ROI) from property sales within 10 days of closing. The agreements also prohibited NHS from diverting ROI to pay down its bank line of credit. The CDBG contract required NHS to deposit proceeds from sales to a bank account maintained for that purpose. The contract also required NHS to use the funds solely for the purpose of financing housing rehabilitation or home ownership. NHS was not to use the funds for operating and other unspecified expenses.

#### **PROGRAM INCOME NOT REMITTED OR PROPERLY DEPOSITED**

For 10 of 19 HOME and CDBG property sales we examined, NHS did not remit or properly deposit \$172,485 in program income. NHS used the proceeds to pay principal and interest on its line of credit secured to provide interim construction financing. NHS also used the LOC to finance non-HUD assisted projects and it sometimes transferred funds between accounts. NHS did not maintain records to support that the \$172,485 paid on the line of credit offset only LOC advances used for HOME or CDBG assisted jobs.

#### **NHS RECONCILIATIONS AND CORRECTIVE MEASURES ARE IN PROCESS**

Prior to March 1996, NHS basically ignored the City's repeated requests to remit or deposit program income. Starting around March 1996 NHS began remitting program income to the City as required by its contract. At the time of our review, NHS had initiated efforts to reconcile the sources and use of program income, including the \$172,485 mentioned above.

#### **AUDITEE COMMENTS**

The City agreed with the finding. The City stated that it became aware of NHS' retention of HOME ROI late in 1994 and struggled for over a year to bring NHS into compliance. Since September 1996, NHS, with assistance from Neighborhood Reinvestment Corporation, has been reconstructing its project financial records and submitting financial close-out reports. Where appropriate, NHS remits program income to the City.

## RECOMMENDATIONS

We recommend that you require the City and/or NHS to:

- 4A. Provide your office with a determination of program income and the use of that income for each HOME and CDBG assisted property starting from the date NHS opened the LO C account.
- 4B. Reimburse the HOME and CDBG Programs for any program income which was not spent for allowable program costs.
- 4C. Establish and implement procedures to ensure that NHS properly controls, accounts for, and uses HOME and CDBG Program income.

## **FINDING 5 - NEED TO IMPROVE PROCUREMENT AND ADMINISTRATION OF CONTRACTS**

NHS needs to improve its procurement and administration of contract services. NHS did not always follow or document compliance with competitive procedures when it procured auction and rehabilitation services. We also found instances where NHS did not properly administer rehabilitation contracts in, for example, documenting problems with contractor performance and their resolution and paying for poor quality work and vandalism. As a result, we could not readily determine if NHS obtained the best competitive prices for contract services or if it used program funds efficiently for contract services.

We examined NHS' procurement of 1994 and 1995 auction services. We also reviewed 34 of the 91 properties rehabilitated for resale during that same period. The review showed that NHS needs to improve contract procurement and administration.

### **NEED TO IMPROVE CONTRACT PROCUREMENT**

#### **Contracts awarded to firms with inside information**

OMB Circular A-110, part 84.43, provides that to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals shall be excluded from competing for such procurement. Despite this directive, NHS awarded its 1994 and 1995 auctioneer service contracts to two firms that performed prior feasibility studies related to the auctions. NHS awarded the 1994 contract to a joint venture firm, Hudson & Marshall and Asset Property Disposition, and the 1995 contract to Asset Property Disposition. Hudson & Marshall was on a task force NHS formed in 1994 to plan and implement procedures, project specifications, and controls for conducting the auction. Also, NHS paid Asset Property Disposition in 1994 to conduct feasibility studies related to the 1994 auction. Thus, both firms obtained inside information concerning the auction process that other bidders did not have. That information gave them an unfair competitive advantage.

#### **Low bidders not selected**

OMB Circular A-110, part 84.46, states that procurement records should include the basis for contractor selection. 24 CFR 84.43 provides that all procurement transactions will be conducted in a manner to provide open and free competition.

In 5 of 34 cases examined, NHS did not award rehabilitation contracts to the lowest bidders. The files did not document why NHS selected contractors who were not the lowest bidders. The contracts were:

<u>Property Address</u>	<u>Low Bid</u>	<u>Selected Bid</u>	<u>Difference</u>
450 Price St.	\$ 27,750	\$ 45,000	\$ 17,250
452 Price St.	27,750	45,000	17,250
454 Price St.	27,750	45,000	17,250
456 Price St.	27,750	45,000	17,250
512 E. Duffy St.	87,900	118,000	30,100

### Basis for Contract Award Not Clearly Documented

OMB Circular A-110, part 84.43, requires that all procurement transactions will be conducted in a manner to provide open and free competition.

In 22 of 34 cases examined (65 percent), NHS did not competitively bid or document the competitive process followed to award rehabilitation contracts. As a result, we could not determine if the costs were reasonable. Specifically, the 22 cases involved the following conditions:

- In seven cases NHS selected contractors who did not bid on the full scope of rehabilitation work planned for the units with resulting costs of \$276,988. In these cases the City's rehabilitation staff obtained bids from contractors for exterior work only. After selecting contractors for the exterior work, NHS and/or the City used the same contractor to perform more extensive rehabilitation of the units with no further competition.
- In four cases NHS did not follow competitive procedures to award work to a second contractor totaling \$140,832 to complete work unfinished by the initial contractor.
- In seven cases NHS did not maintain the original or copies of the competitive proposals submitted by the successful and unsuccessful bidders. For three of the cases we found NHS' bid tally sheets. However, for the remaining four cases we found no record of the competitive process.
- In three cases NHS awarded contracts without documenting how it selected the contractors and established contract prices. NHS' bid tally sheets showed the bids exceeded 15 percent of NHS' cost estimates. We found no evidence that NHS rebid the work. NHS awarded two contracts for \$40,550 and \$30,400 to firms that were not among those shown on the bid tally. NHS awarded the third contract for \$51,000 to a firm that was on the bid tally. However, the contract was for an amount substantially less than the price shown on the bid tally.
- In one case NHS awarded a contract to a firm that submitted a package bid for two properties. The files contained no evidence that NHS provided the other bidders with the option to submit package bids or provide all bidders with the same specifications. Furthermore, NHS awarded the contract for \$6,110 less than the bid amount. NHS' files did not show how it established the lower contract price.

### Independent cost estimates not prepared or documented

OMB Circular A-110, part 84.45, requires the preparation and documentation of cost or price analysis for all procurement transactions.

NHS did not prepare or document independent cost estimates for 12 of 26 rehabilitation cases examined. The estimates were needed to analyze the reasonableness of contractor bids. For instance, for seven of the cases NHS files did not document the competitive

process followed to award contracts that totaled \$324,200. For the remaining five cases, NHS files documented the competitive bid process. Thus the contract amounts, though not supported by independent cost estimates, appeared reasonable based on the competitive bids received.

## **NEED TO IMPROVE CONTRACT ADMINISTRATION**

OMB Circular A-110, part 84.47, requires that a system for contract administration be maintained to ensure contractor performance with the terms, conditions, specifications of the contract, and that recipients evaluate contract or performance and document, as appropriate, whether contractors have met the terms, conditions, and specifications of the contract.

NHS needs to improve its management of rehabilitation contracts in areas related to: (1) documenting files to show problems with contractor performance and the resolution of the problems, (2) poor workmanship; and (3) vandalism.

### Contractor performance problems not properly documented

NHS did not consistently document problems with contractor performance and how or if it resolved the problems. The documentation gap was especially important considering NHS took an average of 258 days to complete the rehabilitation of 26 test properties. The contracts generally required the work to be completed within 120 days. For eleven or 40 percent of the properties, NHS also changed contractors while the work was in process. The following examples illustrate how the lack of documentation impacted HUD programs:

NHS terminated the initial contract for the rehabilitation of properties at 450 to 456 Price Street for poor performance. However, the files did not adequately document the problems NHS claimed to have had with the contractor to support its decision to terminate the contract. The contractor disagreed with NHS' claim that his performance was inadequate. He said NHS contributed to the slow progress of the work by omitting needed roof repairs from its original contract specifications. The contractor stated that he could not do the specified interior repairs without first being authorized to repair the roof because water damage from rain would have ruined the interior work.

NHS terminated the initial contractor and hired another firm without obtaining competitive bids. The new contract included the roof repairs. NHS finally paid \$249,813 for the work initially contracted for \$174,500, an increase of 43 percent. The original contract called for a completion date within 120 days of the Notice to Proceed; the project took 409 days to complete. The owners still complained about problems with the work (see section on poor quality work).

### Payments for poor quality work

We performed windshield inspections of 38 of the 91 properties and walk through inspections of eight of the 38 properties and observed the following conditions:

#### 411 and 413 East Waldburg Street

NHS paid the contractor \$8,000 for roof repairs which were not properly done. The picture illustrates how the leaking roof caused water damage to much of the completed interior work at 411 E. Waldburg Street. (This version of the audit report does not contain this photo.)

As of our review the homeowners still had problems with roof leaks. NHS estimated an additional \$5,582 to correct the substandard work. NHS plans to have another contractor complete the work at added costs to the HUD program. A City rehabilitation specialist approved the work and payment to the contractor as NHS' representative. The inspector told us that he did not physically inspect the work but instead drove by the property and performed a windshield inspection. This was not in accordance with the certification contained on the Payment Certification and Application. On that document the inspector certified that an on-site inspection was made and that the required work was completed.

### Price Street properties

NHS paid two contractors \$249,813 to rehabilitate these properties. At the time of our review the property owners complained about the poor quality workmanship. We inspected the properties and noted the following type problems which validated the homeowner's concerns:

- Leaking roofs and related damage to interior ceiling, walls and floors
- Paint peeling from exterior walls

NHS files did not document which contractor was responsible for the deficient work and was making plans for a third contractor to make the repairs at additional costs to the program. NHS estimated \$7,200 to complete needed repairs at 450 and 452 Price Street. NHS also identified repairs needed at 456 Price Street but had not estimated the cost.

### Vandalism and theft

NHS had not adequately secured and protected the properties it rehabilitated. We inspected two properties that had been vandalized. NHS completed the rehabilitation in 1994 but, as of our review date, the properties remained on the market.

### 516 E. Seiler Avenue

Vandals broke the bedroom window and damaged the drywall in the back two bedrooms. This picture illustrates some of the drywall damage. (This version of the audit report does not contain this photo.)

NHS spent \$64,250 to rehabilitate this house and will now need to incur additional costs to repair this damage.

314-316 E. 33rd Street

NHS completed the work in early 1994 and the property was vandalized by fire. In November 1994 NHS paid a contractor \$16,153 to repair the damage. During our inspection we found the property had been vandalized again. The vandals broke the kitchen and dining room windows and stole the outside air conditioning unit. NHS will incur additional costs to make the needed repairs.

NHS needs to expedite efforts to sell rehabilitated properties and to protect the properties while they are vacant. NHS' laxity has proven costly to HUD programs.

## **AUDITEE COMMENTS**

The City and NHS acknowledged that NHS did not follow or document compliance with proper procurement and contracting procedures. They also acknowledged that contract management was not satisfactory in all cases. The City agreed to recoup the \$8,000 for substandard roof repairs from NHS.

## **RECOMMENDATIONS**

We recommend that you require the City and NHS to:

- 5A. Implement procedures to prohibit individuals or firms that provide planning or feasibility services for a procurement transaction from bidding on contracts for the same services.
- 5B. Implement procedures to ensure that contracts are procured and administered pursuant to requirements.

We recommend that you require the City to:

- 5C. Recoup \$8,000 in CDBG and HOME funds used to pay for substandard roof repair at the Waldburg Street properties, and use the funds to correct the deficient work.
- 5D. Instruct NHS to correct the deficient rehabilitation work (excluding those in recommendation 5C), without further cost to HUD programs, in each case where it paid contractors for deficient work.



**SCHEDULE OF INELIGIBLE AND UNSUPPORTED COSTS**

<u>Recommendations</u>	Amounts	A m o u n t s
	<u>Ineligible<sup>1</sup></u>	<u>Unsupported<sup>2</sup></u>
2A	\$ 53,304	
2C		\$ 76,163
3B		194,303
4A		172,485
5C	8,000	

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<sup>1</sup> Ineligible amounts obviously violate law, contract, HUD or local agency policies or regulations.

<sup>2</sup> Unsupported amounts do not obviously violate law, contract, policy or regulation, but warrant being contested for various reasons such as the lack of satisfactory documentation to support eligibility and HUD approval.

CITY COMMENTS

































NHS COMMENTS





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Chief Financial Officer, F (Room 10164) 2  
Deputy Chief Financial Officer for Finances, FF (Room 10166) 2  
Director, Housing and Community Development, Issue Area, U.S. GAO,  
441 G Street, NW, Room 2474 Washington, DC 20548  
ATTN: Judy England-Joseph  
Assistant to the Deputy Secretary for Field Management, SDF, (Room 7106)  
Michael Brown, City Manager, City of Savannah  
Mark Reavis, Executive Director, Neighborhood Housing Services of Savannah, GA.  
The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs, United States  
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